DIRECTOR-GENERAL OF INLAND REVENUE

v.

HUP CHEONG TIMBER (LABIS) SDN. BHD.

SUPREME COURT, KUALA LUMPUR
HASHIM YEOP SANI SCJ
SYED AGIL BARAKBAH SCJ
WAN HAMZAH SCJ
[FC CIVIL APPEAL NO. 263 OF 1984]
12 APRIL 1985

REVENUE LAW: *Income tax - Whether consideration sum paid for grant of exclusive right to extract timber deductible - Capital and revenue expenditure - Distinguished.*

The respondent, the taxpayer, entered into an agreement with Persatuan Peladang Negeri Johor ("the Persatuan") whereby the respondent was granted by the Persatuan the exclusive right to work out, fell, exploit and extract all timber found on a certain piece of land in consideration of the sum of RM1,400,000. The timber licence to extract timber was applied for and obtained by the taxpayer in its own name. For the purpose of assessment the respondent claimed a deduction of the sum of RM1,400,000 but this was disallowed by the Director-General of Inland Revenue ("the Revenue"). The respondent appealed to the Special Commissioners of Income Tax, who dismissed the appeal. The respondent then appealed to the High Court, and the learned Judge reversed the decision of the Special Commissioners. Hence this appeal to the Supreme Court by the Revenue.

Held:

[1] The sum of RM1,400,000 was not a payment made for the use of a licence or permit to extract timber within the meaning of s. 39(1)(g) of the Income Tax Act 1967 ("the Act").

[2] Where an exclusive right was acquired what is extracted from the land pursuant to the exclusive right is treated in law as stock-in-trade and the payment made to acquire the exclusive right is taken as revenue expenditure and not as capital expenditure.

[3] The sum of RM1,400,000 being a revenue expenditure is a deductible item under s. 33(1) of the Act.

[Appeal dismissed. Costs to respondent before Supreme Court, in High Court and before the Special Commissioners. Relevant assessments of income tax to be varied accordingly.]

Cases referred to:

Lahad Datu Timber Sdn. Bhd. v. Director-General of Inland Revenue [1981] 2 MLJ 97; [1981] CLJ (Rep) 22
Mohanlal Hargovind v. Commissioner of Income Tax [1949] AC 521
Kauri Timber Co Ltd. v. Commissioner of Taxes [1913] AC 771
Hood Barrs v. Inland Revenue Commissioners [1957] 1 All ER 832
Hopwood v. C.N. Spencer Ltd. 2 TC 169
Henriksen v. Graften Hotel Co. Ltd. [1942] KB 184

Legislation referred to:

Johore Forest Enactment 1912, s. 2
Forest Rules (Johore) 1921, rr. 2, 18
Income Tax Act 1967, ss. 33(1), 39(1)(c), (g), 140
Licensing (Consolidated) Act 1910 [UK], s. 14

For the appellant - Abdul Hamid bin Mohamad; SFC
For the respondent - C.V. Das; M/s. Shook Lin & Bok

JUDGMENT

Wan Hamzah SCJ:

Hup Cheong Timber (Labis) Sdn. Bhd. ("the taxpayer") entered into an agreement dated 27 February 1973 with Persatuan Peladang Negeri Johor ("the Persatuan") whereby the Persatuan granted to the taxpayer the exclusive right to work out, fell, exploit and extract all timber found on a certain piece of land about 5,500 acres in area in the Mukim of Buloh Kasap, Johor, in consideration of the sum of RM1,400,00 to be paid by the taxpayer. For the purpose of assessment of income tax the taxpayer claimed a deduction of the sum of RM1,400,000 from its income but this was disallowed by the Director-General of Inland Revenue ("the Revenue") on the following grounds:

(a) that the sum was payable for the use of a licence or permit to extract timber from a forest in Malaysia and therefore under s. 39(1)(g) of the Income Tax Act deduction is not allowed; and

(b) that the sum was a capital expenditure and therefore deduction was also not allowed under s. 39(1)(c).

The taxpayer appealed to the Special Commissioners of Income Tax contending that it was neither a payment for the use of a licence or permit to extract timber nor a capital expenditure but an expenditure wholly and exclusively incurred in the production of gross income and therefore deduction of the sum should be allowed under s. 33(1) in the computation of adjusted income. The Special Commissioners found that the payment was not made for the use of a licence or permit to extract timber, but they held that it was a capital expenditure and therefore they dismissed the appeal. Being aggrieved with the decision of the Special Commissioners the taxpayer appealed to the High Court. In the course of putting up the Case Stated for the opinion of the High Court the Special Commissioners changed their mind with regards to the question relating to s. 39(1)(g) and in the Case Stated they substituted their earlier decision with a finding that the payment was made for the use of a licence to extract timber, thus strengthening further their conclusion that the sum paid was not an allowable deduction. Wan Yahaya J in the High Court reversed the decision of the Special Commissioners and held that -

(a) the sum of RM1,400,000 was not paid for the use of a licence or permit to extract timber under s. 39(1)(g), and

(b) the said sum paid for the exclusive right to work out, exploit and extract timber was not a capital expenditure but a revenue expenditure which is deductible under s. 33(1).

Hence this appeal before us by the Revenue.

At the hearing before the Special Commissioners a Statement of Agreed Facts and an Agreed Bundle of Documents were placed before them. Two witnesses gave evidence for the taxpayer, and the Revenue did not call any witness. The following are the facts of the case gathered from the findings by the Special Commissioners, the Statement of Agreed Facts and the Agreed Bundle of Documents. The taxpayer is a company incorporated on 31 March 1970. The many objects of the taxpayer company listed in its memorandum of association include the following:

> To carry on the business of general merchants in lumbering and to own, carry on and run the business of timber growers, timber merchants and sawmill and timber-yard proprietors, and to buy, sell, grow, manipulate, import, export, and deal in, timber and wood of all kinds and also the business of foresters, charcoal, and charcoal dealers.

The Persatuan is an association formed under the Farmers' Association Act 1967. Since before 1 February 1973 the Persatuan was granted by the State Government of Johore right to fell and extract all the timber found on a certain area of land of about 5,500 acres in Hutan Mergastua, Mukim of Buloh Kasap, District of Segamat, Johor. The Persatuan issued a notice inviting tenders to fell and extract timber from the said land and to develop it into an oil palm and pepper estate. In response to the invitation the taxpayer put in its tender dated 1 February 1973, and became the successful tenderer. By an agreement dated 27 February 1973 entered into between the Persatuan and the taxpayer, the Persatuan granted to the taxpayer the exclusive right to extract all timber in the said land in consideration of the payment of a sum of RM1,400,000 to the Persatuan and in further consideration of developing into an oil palm and pepper estate for the Persatuan and on the terms and conditions set out in the said agreement. The taxpayer paid to the Persatuan the sum of RM1,400,000 stipulated in the agreement. On the application of the taxpayer and with the consent of the Persatuan a licence dated 29 March 1973 was issued in its name under rr. 2 and 18 of the Forest Rules 1921 to fell and extract timber in the said land. The licence was valid for the period from 31 March 1973 to 31 July 1973 and it was renewed until completion of the logging operations by the taxpayer in the said land. The taxpayer completed the development of the said land into an oil palm estate in accordance with the terms and conditions of the agreement, and handed over the oil palm estate to the Persatuan.

Included in the Agreed Bundle of Documents is a copy of the agreement dated 27 February 1973 between the Persatuan and the taxpayer. The agreement consists of eight pages and Appendix A attached to it consists of several more pages. We do not think that it would serve our purpose to reproduce all of the clauses of the agreement, but we would like to refer to certain salient terms contained in the following clauses, in which the Persatuan is referred to as the Landowner and the taxpayer as the Contractor:

1. In consideration of the Contractor agreeing to develop the Area mentioned above into an Oil Palm Estate on behalf of the Landowner and in further consideration of the payments herein paid and to be paid by the Contractor to the Landowner and of all other covenants agreements, conditions stipulations and stipulations herein contained, the Landowner hereby grant unto the Contractor the exclusive right to work out fell exploit and extract all that timber found in the area.

2. (a) The Contractor shall pay the Landowner the sum of Dollars One Million Four Hundred Thousand (RM1,400,000) only which sum shall be paid in the following manner:

   (i) On the execution of this Agreement the Contractor shall pay the Landowner the sum of Dollars Seven Hundred Thousand (RM700,000) only, and

   (ii) On or before the expiration of six (6) months of the issue of the Logging Licence in respect of the timber in the area, the Contractor shall pay the Landowner a further sum of Dollars Seven Hundred Thousand (RM700,000).

   (b) The Contractor shall in addition pay forthwith on demand being made by the Department of Forestry or the appropriate authority the Forest Premium as fixed by the Department of Forestry or such authority for the area and the deposit required in respect of the issue of Logging Licence or other licences such as may be required.

3. It is a term of this Agreement that the Contractor shall commence felling and extraction operation upon the issue of Logging Licence and in any case not later than one week after the issue of such licence.

4. It is a further term of this Agreement that the granting to the Contractor the contract to fell the timber in the area is subject to and on the undertaking that the Contractor shall develop the whole of the area totalling 5,500 acres into an oil palm estate (hereinafter referred to as the estate) on behalf of the Landowner in the manner hereinafter appearing and in accordance with the specification conditions and restrictions contained in the Schedule attached hereto and marked appendix A which shall form and be read as part of this Agreement and further shall be subject to the Contractor maintaining to the satisfaction of the Landowner the whole of the said estate up to the oil palm last planted thereon is one year of age upon which the Contractor shall hand over the Estate to the Landowner.

5. The Contractor shall work the said area in an orderly skilful and workmanlike manner and subject to the regulations and rules imposed under the Forest Act, Ordinance or Enactment for the time being in force and with the terms and conditions of the licence issued to the licence holder and shall be liable to fully indemnify the Landowner for any expenses which he may incur whether as fine inflicted on it or otherwise on account of any breach of this clause by the Contractor.

6. (a) The Contractor shall fell and extract all the timber within the designated area of at least 2,000 acres in a manner which shall from time to time be determined by the Forest Department and shall not pursue any other designated area until all the economically utilisable timber in the first designated area have been extracted to the satisfaction of the Landowner and the District Forest Officer and until such time as to the satisfaction of the Landowner the area scheduled to be planted with oil palm has been duly planted.

(b) The Landowner his agent or representative shall at all times have the absolute right to supervise the logging and extracting operation and the Contractor shall at all possible times conform to their requests, directive and supervision whenever required to do so.

7. The Contractor shall complete work in the first two blocks Nos. 1 and 2 totalling approximately 2,000 acres, as shown in the plan annexed hereto and marked Appendix B to the satisfaction of the Forest Department within twelve months from the date of issue of the Licence by the Forest Department. The remaining blocks Nos. 3, 4, 5 and 6 totalling (3,500 acres?) according to the schedule in Appendix A.

8. ...

9. ...

10. ...

11. If the Contractor shall leave any timber in any designated area made available to him for a period longer than one month after the licence relating to such designated area has expired, or shall at any time during the continuance of such licence leave any felled timber in the area for a period longer than one month after it has been felled, such timber shall become the property of the Landowner and may be disposed off by the Landowner as it thinks fit and in such case the Contractor shall have no further claim thereto nor to any compensation for the use of any roads constructed by the Contractor by the Landowner for the purpose of removing the said timber from such area.

The tender notice together with the plans, specifications, conditions and other documents in respect of the tender was adopted as and became Appendix A to the agreement. The following is an extract from Appendix A:

Tender for Jungle Felling, Burning, Pruning Etc., for Village and Agricultural Development.

Tenders are invited from experienced contractors for the above works at the undermentioned development schemes:

Oil Palm Area

Mukim	Daerah	Phase	Approximate Acreage	Year
Buloh	Segamat	I	2,000	1974
Kasap		II	2,000	1975
		III	1,500	1976

Date of completion as per time table of works.

Included in Appendix A is the time table works for 1974, but no time tables of works for 1975 and 1976 are included. We believe that what is extracted above is "the schedule in Appendix A" referred to in Clause 7, because there are no other schedules in Appendix A which can be understood to be the schedule referred to in Clause 7. A specification called "Specification for Mechanical Felling by Cutting to Ground Level and Clearing" is also included in Appendix A. In para. 7 of that specification it is stated as follows:-

The cutting of all trees, blukars, bamboo slumps, bartam palms and any other standing, creeping vegetation, shall leave the area cleared to ground level in a "clean swept" condition.

We propose to consider first the issue whether the sum of RM1,400,000 was paid for the use of a licence or permit to extract timber under the following provisions of the Income Tax Act 1967:

Section 39(1). Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of

(g) any sum, by whatever name called, payable (otherwise than to a State Government) for the use of a licence or permit to extract timber from a forest in Malaysia.

For the contention that deduction of the sum was not allowed under s. 39(1)(g) the Revenue relied on the judgment of the Privy Council in the case of *Lahad Datu Timber Sdn. Bhd. v. Director-General of Inland Revenue* [1981] CLJ (Rep) 22 in which the facts were as follows. A parcel of State Land approximately 4,364 acres was alienated to a co-operative society for agricultural development. The society was also given a licence with rights to extract, remove and sell the timber. The society entered into two agreements with the appellants. Under one agreement the appellants were to fell and cut timber from specified blocks of the land and to remove the timber to a log pond on payment of RM1 per cubic foot of timber. The second agreement was for the sale of the timber by the appellants on behalf of the society and for certain works to be undertaken by the appellants in the development of the land, under which the appellants were to pay to the society or to a contractor for the society a fixed sum by installments, to cover the assessed costs of planting part of the area with coconuts and cover crop, of maintenance of the planted area for six months, and for twelve miles of fencing. The Privy Council held that the two agreements must be treated as one integral bargain between the two parties, and proceeded to state a summary of the contract between them as follows:

> The Society had from Government the right to extract and sell timber from the designated areas, subject to obligations as to construction (of road houses, school, teachers' quarters, community centre, staff quarters, playing field and rest house), planting and fencing ... The Society and the taxpayer agreed (without formal assignment of the Government licence) that the taxpayer should, directly or indirectly, exercise the Society's rights and perform the Society's obligations in exchange for payment by the taxpayer to the Society of 21 cents (or 5 cents) per cubic foot of timber extracted, sold and exported. Nothing was to be paid by the Society to the taxpayer ... The taxpayer's gross remuneration for its work on extraction, removal to the log pond, maintenance of the log pond, and merchandising was to be the proceeds of sale, less a fixed commission to the Society per cubic foot sold, and subject to the obligation to pay to the Society (or its nominated contractor) the other sums for planting, etc. ... and also the royalty due to the State.

It was held that (1) the fixed commission paid by the taxpayer to the Society, (2) the planting payments made by the taxpayer to the Society and (3) the development cost incurred by the taxpayer, fall squarely within the description of sums payable for the use of a licence or permit to extract timber, within the provision of s. 39(1)(g) of the Act.

In our opinion there is an important distinction between that case and the case before us in that in the instant case there was no finding by the Special Commissioners that the Persatuan had a licence to extract timber, and it is not disputed that it was the taxpayer who held such licence. It can be safely assumed that the Persatuan had no such licence. In our opinion it would be absurd to suggest that the taxpayer paid RM1,400,000 to the Persatuan for use of the taxpayer's own licence. There can be payment by a person for the use of a licence if the licence belongs to another person, as in the *Lahad Datu* case. In our opinion "a licence or permit to extract timber from a forest" contemplated in s. 39(1)(g) is a licence or permit issued under the law for the time being in force relating to extraction of timber from the forests (which in the present case is the Forest Enactment 1912 of Johor together with the Forest Rules 1921 of Johor) and it does not mean a mere right to extract timber. What the Persatuan had was a right to extract timber but not a licence or permit to extract timber and therefore there is no question of payment being made for the use of the Persatuan's licence or permit to extract timber. The licence to extract timber was issued to the taxpayer with the consent of the Persatuan in accordance with the following provisions of the Forest Rules 1921:

> Rule 18. (i) Subject to any existing legal or customary right, no forest produce of a kind included in s. 2 of the Enactment shall be removed from any alienated land, except under and in accordance with the conditions of a licence as in Form I of Schedule II or of a permit as in Form II of Schedule II, under the hand of a Forest Officer.
>
> (ii) Such licence or permit may be issued to the owner of such land or with his consent to any other person, and, subject as aforesaid, forest produce removed thereunder, whether manufactured or in its natural state, shall be liable to royalty at the rates prescribed for such produce by Schedule I.

It was perfectly in order and regular for the taxpayer to hold the licence. It was argued that since the licence was issued with the consent of the Persatuan the payment was made for the use of the licence. We do not see how such inference can arise.

For holding that the payment of the sum of RM1,400,000 was made for the use of a licence to extract timber the Special Commissioners stated their ground as follows:

We are convinced that the logging licence was not issued to the Appellant on its own merits simply because at the relevant time the Appellant did not own the said land. On the contrary, it was clearly stated in the logging licence that the said land was owned by the Persatuan. Having received part payment of the said sum, the Persatuan consented that the logging licence be issued to the Appellant in its own name.

We believe what the Special Commissioners meant was that the taxpayer would not be able to extract timber unless a licence to extract timber was taken out and the taxpayer would not be able to take out a licence to extract timber without the consent of the Persatuan and the Persatuan was induced to give its consent by the payment of the first instalment of RM700,000. In our view payment for obtaining consent for the issue of a licence is not the same thing as payment for the use of a licence. It is also our view that payment for obtaining such consent is not what is contemplated in s. 39(1)(g). Moreover, there is nothing in the agreement to show that any part of the sum of RM1,400,000 was intended to be consideration for giving consent to the issue of a licence to extract timber in the name of the taxpayer.

Before us Counsel for the Revenue confirmed what is apparent from the appeal record, i.e. that the Revenue did not rely on s. 140 of the Act or act in pursuance of that section. The following is the relevant portion of that section:

(1) The Director General, where he has reason to believe that any transaction has the direct or indirect effect of -

(a) altering the incidence of tax which is payable or suffered by or which would otherwise have been payable or suffered by any person;

(b) relieving any person from any liability which has arisen or which would otherwise have arisen to pay tax or to make a return;

(c) evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by this Act; or

(d) hindering or preventing the operation of this act in any respect,

may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustments as he thinks fit with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction.

(2) In exercising his powers under this section, the Director General may -

(a) treat any gross income from any source of any person either as the gross income and source of any other person or, where the gross income is that of a controlled company, as having distributed to any member (within the meaning of s. 139(7)) of that company;

(b) make such computation or recomputation of any gross income, adjusted income or adjusted loss, statutory income, aggregate income, total income or chargeable income of any person or persons as may be necessary to revise any person's liability to tax or impose any liability to tax on any person in accordance with his exercise of those powers; and

(c) make such assessment or additional assessment in respect of any person as may be necessary in consequence of his exercise of those powers, nullify a right to repayment of tax or require the return of a repayment of tax already made.

(3) Without prejudice to the generality of the foregoing subsections, the powers of the Director General conferred by this section shall extend -

(a) to the charging with tax of any person or persons who but for any adjustment made by virtue of this section would not be chargeable with tax or would not be chargeable with tax to the same extent; and

(b) to the charging of a greater amount of tax than would be chargeable but for any such adjustment.

(4) ...

(5) Where in consequence of any adjustment made under this section an assessment is made, a right to repayment is refused or a return of a repayment of tax is required, particulars of the adjustment shall be given with the notice of assessment, with the notice refusing the repayment or with the notice requiring the return of a repayment, as the case may be.

If from evidence the Revenue was satisfied that the transaction whereby the taxpayer paid the sum of RM1,400,000 to the Persatuan was a transaction made for the purpose of evading or avoiding liability to pay income tax, the Revenue should take action pursuant to s. 140 to make adjustment with a view to counteracting the effect of the transaction, and in that event the Revenue should under subsection (5) give to the taxpayer particulars of the adjustment together with the notice of assessment.

As already stated, the other issue in this case is whether the payment was a capital or a revenue expenditure. Relating to this issue several decided cases were cited to us for the Revenue and for the taxpayer. Some of the cases cited were cases of acquiring right to extract timber, some were cases of acquisition of land with the right to extract the timber thereon and some were cases of outright purchase of standing timber. Bearing in mind that the present case is not a case of outright purchase of standing timber but one of acquiring the right to extract timber, we examine first a case involving acquisition of the right to take away something from the land -

Mohanlal Hargovind v. Commissioner of Income Tax [1949] AC 521:

The appellants, who were manufacturers and vendors of country made cigarettes, obtained tendu leaves under short term contracts with the Government and other owners of forests entered into by the appellants wholly and exclusively for the purposes of their business - to supply themselves with one of the necessary raw materials - and which simply and solely gave to the appellants the right, in consideration of a sum payable by installment, to pick and carry away the leaves. Two of those contracts were typical of the rest. One was dated 5 September 1939 and was made between the Divisional Forest Officer on behalf of the Secretary of State in Council and the appellants' representatives. In that contract the subject - matter was described as "the forest produce sold and purchased under the agreement" and the quantity of the forest produce was defined as all the said produce "which may now exist or may come into existence in the contract area which the forest contractor (the appellants' representative) may remove from the said area during the period from 5 September 1939 to 30 June 1941." The contractor was allowed to coppice small tendu plants a few months in advance to obtain good leaves and to pollard tendu trees a few months in advance to obtain better and bigger leaves. The other typical contract was substantially in the same form as the first, with certain minor differences. The period of the operation was 1 October 1938 to 30 June 1941 and the work was to be commenced on 1 October 1938. It recited an application for the grant of "the contract of collecting and removing" tendu leaves. The grant was a grant of the right to collect and remove them from the area described in the case of each contract a sum payable by installments was fixed as the consideration for the grant. The issue was whether the sums paid by the appellants under the contracts were expenditure on revenue account and should be allowed as deduction in the computation of the profits and gains of their business for income tax purposes. The following are passages from the judgment of the Privy Council:

> It appears to their Lordships that there has been some misapprehension as to the true nature of the agreements and they wish to state at once what in their opinion is, and what is not, the effect of them. They are merely examples of many similar contracts entered into by the appellants wholly and exclusively for the purpose of their business, that purpose being to supply themselves with one of the raw materials of that business. The contracts grant no interest in land and no interest in the trees or plants themselves. They are simply and solely contracts giving to the grantees the right to pick and carry away leaves, which of course implies the right to appropriate them as their own property ... The contracts were short term contracts. The picking of the leaves under them has to start at once, or practically at once, and to proceed continuously. It is true that the rights under the contracts are exclusive, but in such a case as this that is a matter which appears to their Lordships to be of no significance... Their Lordships feel no doubt that in a business sense this expenditure is expenditure on revenue account and not on capital account just as much as if the tendu leaves had been bought in a shop. Under the contracts it is the tendu leaves and nothing but the tendu leaves that are acquired. It is not the right to pick the leaves or to go on to the land for the purpose - those rights are merely ancillary to the real purpose of the contracts and if not expressed would be implied in the sale of a growing crop ... Cases relating to the purchase or leasing of mines... do not appear to their Lordships to be of assistance: nor do their Lordship consider that the elaborate distinction between movable and immovable property drawn in the judgment affords in such a case as the present a reliable test ... In the present case the trees were not acquired, nor were the leaves acquired until the appellants had reduced them into their own possession and ownership by picking them ... If the tendu leaves had been stored in a merchant's go-down and the appellants had bought the right to go and fetch them and to reduce them into their possession and ownership it could scarcely have been suggested that the purchase price was capital expenditure. Their Lordships see no ground in principle or reason for differentiating the present case from that supposed.

It was held that the sums paid were expenditure on revenue account and allowable for deduction.

The *Mohanlal's* case shows that where an agreement is expressed as one for the transfer of a right to remove certain things from the land as distinct from one for the sale and purchase of the things, nevertheless under appropriate circumstances the things removed from the land are treated as if they were bought for the purpose of being used as stock-in-trade and the payment made as consideration for the acquisition of the right to remove is treated as revenue expenditure. We now examine other decided cases cited to us:

Kauri Timber Co. Ltd. v. Commissioner of Taxes [1913] AC 771:

The company was incorporated in 1888 and has since carried on in New Zealand the business of cutting, milling, selling and exporting timber. Among the objects set out in its memorandum were-

(a) to purchase and acquire lands of any tenure, any kauri and other timber, in the Colony of New Zealand;

(b) to purchase and acquire on any terms the company may think fit the rights of any person under any contracts made or to be made by them for any such purchase as aforesaid;

(c) to carry on the business of sawmill proprietors and timber merchants.

Immediately after its incorporation the company, for the purpose of enabling it to carry on the said business, acquired bush properties in New Zealand, either by outright purchase of the land with the standing timber upon it or by purchasing the timber with the right to cut and remove it at any time during a stated period, which in most instances was 99 years.

From time to time since 1888 the company similarly acquired other timber properties for the purpose of its business. In almost all cases the company paid a lump sum for the timber and rights acquired. By far the larger portion of the timber cut by the company from its lands was from the lands acquired in 1888 when it first commenced business. The issue was whether, in striking the annual profits of its business for the purpose of taxation the company was to make deduction in respect of the value of the standing timber which it had cut.

Delivering the judgment of the Privy Council, Lord Shaw after stating the facts of the case, went on to say:

> The Board was informed in the course of discussion that at least a considerable portion of the property was acquired under leases for a period of 99 years. This is the first salient fact in the case. The second is that there is no obligation upon the company immediately to cut down and remove the timber, or indeed to do so at any specific date, their rights with regard to the timber being co-extensive in time with the currency of their leases. The case is thus removed, in fact, from any analogy with decisions quoted at their Lordships' Bar, in which a sale of standing timber was coupled with the duty of its instant removal from the ground ... It appears to the Board that the present case involves no refinement of distinction, for the transaction under which these timber rights were acquired was not one under which a mere possession of goods by a contract of sale was given to the appellant company, but was one under which they obtained an interest in, and possession of, land. So long as the timber, at the option of the company, remained upon the soil, it derived its sustenance and nutriment from it. The additional growths became *ipso jure* the property of the company. All rights or possession necessary for working the business of cutting or even for preserving uninjured the standing and growing stock of timber were ceded under the leases. All this, together with the business facilities for removal and sale, was granted to the company, which became thereby invested with the possession of, and an interest in, the land ... So far for the view of the common law. From the point of view of accounting and finance, the matter appears equally clear. There can be no question that the cost of acquisition of this possession of, and interest in, land, and of the timber rights thereon was just as plainly a capital on cost as if the land, with the timber upon it, had been bought outright. And just as plainly it was not a proper accounting debit item as against revenue.

So it was held that the company was not entitled in its assessment for income tax to make any deduction from the gross proceeds of its business in respect of the value of the standing timber which it had cut.

Hood Barrs v. Inland Revenue Commissioners [1957] 1 All ER 832:

This was an appeal to the House of Lords. The facts of the case were stated in the judgment of Lord Keith *inter alia* as follows:

> The appellant carries on business as a timber merchant, saw-miller and joiner under the name Killiechronan Sawmills and Joinery Works, Killiechronan, Aros, Isle of Mull. He commenced business on 6 April 1947. He is also a shareholder and director of a company known as the Chalmers Property Investment Co. Ltd. (hereinafter called "the Company') which owns a large estate in the Isle of Mull. He holds forty-nine shares in the company out of an issued capital of a hundred shares. On 30 September 1947, and 30 September 1948, the appellant and the company entered into two agreements. Apart from the schedules to the agreements, the prices mentioned therein and the dates from which the agreements were to run, these agreements are in identical terms, and it will be sufficient to quote in full the material portions of the first agreement. The company (called "the vendors') and the appellant (called "the purchaser') agreed as follows:

1. The vendors will sell and the purchaser will buy as at 7 April 1947, all the timber specified in the First part of the Schedule now standing and growing in or upon the forests referred to in the Second part of the Schedule hereto which forests form part of the vendors' estate situate and being at Killiechronan Aros Mull together with the boughs branches and other parts of the same trees respectively down to the soil whereon the same shall be growing but not the roots or other parts thereof which shall be within or below the surface of the soil together with the following powers and authorities namely: Full and free power and authority for the purchaser his servants agents and workmen to go to and return from the lands upon which the said trees are situate through over and along the existing or usual roadways or tracks for the purpose of felling cutting or sawing up and carrying away or otherwise dealing with the said trees and the boughs tops logs and bark thereof at all usual and convenient times and also to top lop and strip off the bark thereof and also to place and dry the bark of the said trees on convenient parts of the said premises to be appointed by the vendors or their agents for that purpose and also for any of the purposes aforesaid to employ horses wagons motor traction and other mechanical contrivances which may be necessary or convenient and also to dig and use sawpits and stages and erect and construct sawmills and other erections and to break and saw up the said timber and stack up the same upon proper and convenient parts of the grounds.

2. The purchase price shall be the sum of £24,275.

3. The purchaser may mark fell and carry away all the said trees and complete all the operations authorised at such times as he the purchaser shall consider convenient.

4. The cutting of the trees and all the operations hereby authorised shall be done in a proper customary and workmanlike manner and so as to cause as little injury or damage as possible to the standing timber underwood grass crops and other property of the vendors or its tenants and the purchaser shall make compensation for all injury or damage which he shall commit or occasion in or upon the vendors' lands.

5. ...

6. ...

The Schedule above referred to
First Part
500 sitka or silver spruce
500 pinus silvestris or contorta
10,000 larch, large
1,000 larch, small

Second Part
Parice Choille
Old Killichronan
Coire Pholachie
Garden Plantations
Narrow Plantations
House Park Wood

In the second agreement entered into exactly a year later and operative as at 7 April 1948 the price agreed was £24,900 for further lots of trees in the same forests specified as follows:

200 common ash, selected
100 common oak, selected
20,000 larch, large
1,000 larch, small

For the purpose of this appeal I shall accept that the trees were ripe for cutting ... .

It was held by the House of Lords (Lord Oaksey dissenting) that the two sums of £24,275 and £24,900 paid by the appellant under the two agreements were capital expenditure by the appellant and should not be taken into account in computing his trade profits. This was how Lord Keith arrived at that conclusion: he said -

> The member of trees here was very large, thirty thousand large larch, and two thousand small larch, as well as other conifers and a quantity of hard timber. There is no evidence that there was any immediate outlet for such a large quantity of timber. The appellant's balance sheet shows him as possessing at 31 March 1948, relatively modest plant and machinery costing some £832, and some tools and equipment costing some £118; a total of £950. These figures do not suggest that the appellant was able to cope within any short period of time with the large quantity of trees made matter of the agreements. Further, the trees under the two agreements were quite unidentified, though, no doubt understood to be trees of varying average sizes or contents. The appellant was to "mark fell and carry away all the said trees and complete all the operations authorised at such times as he the purchaser shall consider convenient". As was observed in the Court of Session, this absence of any time limit presents an unusual feature. It gives the appellant a right to defer the cutting of the trees for a very long period, if not indefinitely, though practical considerations and the ripe condition of the trees might well stimulate the appellant to exercise his rights with such promptitude as was consistent with his capacity and opportunity to do so. The fact, however, remains that, when the agreements were completed, he had no right of property in a single tree. He had merely a right to select and thereafter to cut. Even by selection he acquired no property in the trees. He could obtain no property in any part of a tree till he had felled it to the ground. I find it impossible to hold that this very peculiar right is capable of being treated as stock-in-trade of the appellant. The nature of the right, the indefiniteness of the period for its exercise, and the lack of identification of the trees on which the right was to be exercised, to which may be added the size of the transaction and the absence of any evidence of intention or means to complete it within any foreseeable time, all, in my opinion, negative the idea that the appellant had anything that could be called stock-in-trade.
>
> In my opinion, what the appellant acquired here was merely a right to go on to the company's land to mark, cut and carry away such trees, up to a specified number, as fell within the size and description mentioned in the agreements. The money paid for this right was, in my opinion, a capital and not a revenue expenditure.

Hopwood v. C.N. Spencer Ltd. 2 TC 169:

This was an appeal from the decision of the Commissioners for Special Purposes by way of Case Stated, heard in the High Court of Justice (Chancery Division). The facts and the issue in the case were stated by Buckley J in his judgment as follows:

> The Company was incorporated in the year 1920 and has since that time carried on the business of sawmillers and timber merchants. It produces and sells wood rough sawn to customer's specification for various kinds of use, and for the purposes of its business it has to maintain considerable reserves of timber. It obtains its supplies by buying trees where it can and on what terms it can in varying quantities, ... sometimes, though rarely, in lots of as many as 1,000 trees at a time. Sometimes the Company buys trees with either the right or the obligation to cut the trees; sometimes it buys the land upon which trees are standing. At the relevant time, which is in the year 1951, the Company had as its directors three brothers of the name of Spencer who were both controlling shareholders and the directors of the Company. In 1951 the three Spencer brothers bought at auction 143 acres of natural woodland called Brickhill Wood at the price of £9,250 ... The whole of that purchase price ... was provided by the Company, although the purchase was not in the name of the Company but in the name of the Spencer brothers ... No formal agreement was ever made between the Spencer brothers and the Company, but it was not disputed that the Company became the owner of all the timber in the wood ... the property in Brickhill Wood remained that of the directors personally, the standing timber only being transferred to the Company. The wood in question is close to

the Company's sawmill and it is found as a fact in the Case Stated that the Spencer brothers bought the wood so that the Company would have a reserve of timber. It is also found that the Company expected to clear the wood within seven to ten years for the purpose of meeting ordinary current requirements of its sawmill. The wood comprised 1,104 trees of varying quality and the expectation that it would be cleared within seven to ten years was more or less fulfilled in the event ... So it appears that within eleven years the Company had taken out of the wood all the timber that was of value to the Company. When the wood was bought in 1951 the trees in it were already mature and, indeed, the wood was on the point of beginning to decline. I understand that finding to mean that at the date of the purchase this wood was already ripe for clearance. The question which arises in this case is whether in these circumstances the Company was justified in bringing the trees in Brickhill Wood into its trading account as stock at the cost ... or whether the expenditure was to be regarded as ... or whether the expenditure was to be regarded as expenditure of a capital nature and so excluded from the figures taken into consideration in arriving at the profits or gains of the Company's business for income tax purposes.

Buckley J stated further as follows:

It is not contended that if stock is bought it must be stock that is required for immediate sale in the business, and it seems to me that in considering what period it is reasonable to cater for in buying stock, one must have regard to the nature of the business, the nature of the commodity dealt in the business, the availability of that commodity on the market, and the economic considerations as to when and in what quantities it is desirable for the merchant to buy the stock in question. A purchase is nonetheless a purchase for stock because it is a purchase which is directed to enabling the merchant to have supplies available for some period in the future. The length of the period must, I think, depend upon the sort of circumstances I have mentioned. It is, I think, important first of all to consider in the present case what the Company acquired. Mr. Monroe says that there is a finding of fact in the Case that what the Company acquired was a right to fell the timber. I do not think that is so, with respect to him. I have read the passage from the Case which refers to the Company purchasing the right to fell all the timber, but I do not think that the Commissioners were there purporting to find as a fact that this was precisely the right or the whole of the right and interest that the Company acquired, for they go on to say in the same sentence: "... the rights which the Company acquired were never defined with precision." It seems to me that in law the position must be this: the Company provided the whole of the purchase price for this wood. *Prima facie,* the Spencer brothers would have been constructive trustees for the Company, not only of the standing timber but of the soil in the wood. That position is only modified in this respect, that it was common ground that the Company became the owner of the timber in the wood but that the Spencer brothers remained the owners of the land. It appears to me, therefore, that the ownership of the timber was severed from the ownership of the surface of the land and that the Company acquired a proprietary interest in the timber. The Company became the owners of the trees with, no doubt, such rights as were necessary to enable them to go on to the land to fell the trees. I therefore proceed to consider the case upon the footing that the Company's right or interest was not confined merely to a right to fell the trees and take them away, as Mr. Hood Barrs' was, but was a proprietary interest in the trees, and not in trees to be selected, but in all the wood, in all the 1,104 trees. They were the property of the Company from the moment that this purchase was made. The purchase was made in the expectation that those trees, or at any rate such of them as were of any value for the purpose of the Company's business, would be used in that business and felled for use in that business within seven to ten years. The trees were already ripe for cutting. There was no advantage to be gained in leaving them standing, except the convenience of the Company. Therefore, it seems to me that there is sense if I may so put it, in Mr. Graham's submission that the Company was, effect, merely using the wood as a warehouse for its property from the time of the contract until the trees were felled and removed; and in fact, as I have said, all the trees of such quality that they were useful in the Company's business were felled and used within a period of eleven years.

So it was held by Buckley J that the Company acquired a proprietary interest in the standing timber, and not merely a right to fell the trees and take them away; and it was further held that the Special Commissioners were justified in their conclusion that the purchase was a purchase of stock-in-trade.

We find a number of features in the instant case which point to the conclusion that the sum of RM1,400,000 incurred and paid by the taxpayer was revenue expenditure. Reading Clause 3 and 7 together with the schedule in Appendix A as extracted above, we find that the taxpayer had to commence timber felling and extraction operations soon after 29 March 1973 (the date of the licence to extract timber), and to complete such operations in the first 2,000 acres not later than 29 March 1974, in the next 2,000 acres in 1975 and in the last 1,500 acres in 1976. So the period for extraction and removal was short just as in Mohanlal's case. The instant case was not one in which the taxpayer acquired an interest in the land or the taxpayer could wait for a long or an indefinite time before felling, or the taxpayer could allow the trees to grow on the land deriving sustenance and nutriment from it until they became ripe for felling, as in *Hood Barrs'* case or the case of *Kauri Timber.* Under the agreement in the instant case the taxpayer's obligation was to complete the felling and extraction of timber within a period of less than four years from 1973 to 1976. Similar to *Mohanlal's* case the present case was a case of implied right of the taxpayer to appropriate the timber on felling the trees and extracting them, and just as in *Hopwood's* case the taxpayer acquired proprietary interest in all the trees on the land, not in trees to be selected, because under the agreement no selection of trees was to be done as in *Hood Barrs'* case but the taxpayer had to fell and remove all trees. It appears that the land had to be swept clean of all trees and other vegetation in order to prepare for the planting of oil palm and pepper. There is no doubt that the taxpayer was carrying on the business of dealing in timber. This is shown by the statements of accounts of the taxpayer included in the Agreed Bundle of Documents. It incurred an expenditure of RM1,400,000 and thereby acquired a ready source of instant supply of stock-in-trade, i.e. timber, which was utilised within a short period. The expenditure was thus incurred on revenue account.

In the course of giving the grounds for their decision the Special Commissioners stated as follows:

> It is our finding of fact that the Appellant had acquired the monopoly (i.e. the "exclusive right") as a result of the said payment. The monopoly by itself is an asset or an advantage to the Appellant. It is quite clear that an "enduring benefit" need not endure for long: see *Henriksen v. Graften Hotel Co. Ltd.* [1942] KB 184. In that case, a publican's licence for three years has been so regarded.

After examining several decided cases the Special Commissioners went on to say:

> ... we are of the view that in our present appeal the payment of the said sum is of a capital nature because by the payment the Appellant had acquired a capital asset namely the monopoly (i.e. the exclusive right) to work out exploit and extract timber in the said land and this monopoly (i.e. the exclusive right) cannot be stock-in-trade.

Our first comment on the Special Commissioners' reliance on *Henriksen's* case is that they did not seem to appreciate the fact that the issue in that case did not relate to question of enduring benefit at all, nor to matter of stock-in-trade. Secondly we observe that the Special Commissioners referred to the exclusive right in the present case as monopoly and they seemed to be obsessed with the notion of monopoly. With the notion of monopoly in their mind they seemed to be unduly impressed by *Henriksen's* case which was a case concerning monopoly value. Briefly the facts of that case were as follows:

Tenants of licensed premises, by agreement with the landlord, paid by installments the monopoly value fixed by the licensing justices under s. 14 of the Licensing (Consolidated) Act, 1910. In computing their profit for the purposes of income tax they claimed to deduct, as disbursements wholly and exclusively laid out for the purposes of their trade, the amount of the installments. On appeal to the King's Bench Division it was held that the sums paid as monopoly value which was imposed as a condition of the grant of a licence were of the nature and quality of capital payments and not deductible. So the subject matter in *Hernriksen's* case was payment of statutory charges and it was so different in character from the payment in the present case that we do not think that the decision in that case can be of any help in the present case. Further, it seems that the Special Commissioners did not sufficiently consider the fact that in proper cases as in *Mohanlal's* case, where an exclusive right was acquired what is extracted from the land pursuant to the exclusive right is treated in law as stock-in-trade and the payment made to acquire the exclusive right is taken as revenue expenditure. It does not appear that the Special Commissioners were mindful of the following observation of the Privy Council in *Mohanlal's* case:

It is true that the rights under the contracts are exclusive, but in such a case as this that is a matter which appears to their Lordship to be of no significance.

We agree with Wan Yahaya J that the decision of the Special Commissioners should be reversed and therefore we dismiss this appeal, with costs to the taxpayer here, in the High Court and before the Special Commissioners. The relevant assessments of income tax should be varied accordingly.

Also found at [1985] 2 CLJ 202